Chapter 8
Investment Property

Reference: IAS 40

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1. Introduction

In this chapter you are introduced to the topic Investment Property. The international accounting standard, IAS 40: Investment Property, requires that the entity differentiate between owner-occupied properties and Investment Property. This differentiation is so as to improve the usefulness of the financial statements. Note that the definition of property includes both land and buildings.

2. Definitions

The following definitions have been summarised to an extent and incorporate comment from IAS 40.8 and IAS 40.9. The full definitions are found in IAS 40.5.

Carrying amount: the amount at which the asset is recognised in the statement of financial position.

Cost: the amount for which the asset was purchased. It includes:
- cash or cash equivalents paid or the fair value of any other considerations given;
- at the time of acquisition or construction; or
- the amount recognised as the cost of the asset in terms of another IFRS.

Investment property:
- land or buildings (or both, or part thereof)
- held by an owner or by a lessee under a finance lease
- to earn rentals or for capital appreciation or both.

Owner-occupied property:
- is land or buildings (or both)
- held by an owner or by a lessee under a finance lease
- used in the production or supply of goods and services or for administrative use.

3. Initial recognition and measurement (IAS 40.16 - .29)

3.1 Overview

Investment property is an asset and must therefore meet the definition and recognition criteria relevant to assets as set out in the Framework before it may be recognised.

Investment property is initially recognised in the financial statements at cost. Cost includes:
- the purchase price;
- any construction costs if self developed up to the stage of completion (but excluding abnormal wastage, start up costs and initial operating losses);
- any transaction costs or duties; and
- directly attributable expenses (for example lawyer’s fees, transfers costs and taxes).

The following are examples of property that would be classified as investment property:
- property held for long-term capital appreciation;
- property leased out under an operating lease;
- vacant property held for the purpose of leasing in the future; and
- land and buildings held for an undetermined use.

The following are examples of property that would not be classified as investment property:
- property that is leased out to an entity under a finance lease;
- property held for sale in the ordinary course of business (this is inventory: IAS 2);
- property that is owner-occupied (note 2);
- property in the process of being constructed or developed (note 1) (this is property, plant and equipment: IAS 16).
Note 1 Where construction is occurring on your property, remember that IAS 40 will apply if your property is an existing investment property that is being re-developed for continued use as an investment property (i.e. it will not apply to the development of a new property).

Note 2 The following are examples of owner-occupied property:
- administration buildings;
- factory buildings or shops;
- employee housing.
- Property being constructed or developed on behalf of third parties

Example 1: intentions
Pillow Limited was in the process of constructing a building when, due to financial difficulties, it could not complete the construction thereof. It has the following options:
- Sell the building as is, (Pillow Limited does, on occasion, sell buildings);
- Hold the building 'as is' for capital appreciation; or
- Borrow from the bank and complete the building, then lease this building out to a tenant.

Required:
Explain how Pillow Limited should account for the building under the three options above.

Solution to example 1: intentions

Comment: this example explains how the entity’s intentions regarding the building determine the method of accounting.
- If the intention is to sell the building in the ordinary course of business activities, it must be accounted for as inventory. It should therefore be measured at the lower of cost and net realisable value in terms of IAS 2: Inventories.
- If the intention is to keep the building for capital appreciation, the building will be classified as investment property. Pillow Limited has the option to account for this building under the fair value model (preferred by IAS 40) or the cost model.
- If the intention is to borrow from the bank and complete the building, the building would be classified as property, plant and equipment. Buildings under construction, which will be leased out in the future as investment property, must be accounted for under the cost model, as per IAS 16. Borrowing costs must be capitalised if the building is a qualifying asset. If it is not a qualifying asset, the borrowing costs must be expensed. When the building is complete, it may then be transferred to Investment Property if Pillow Ltd intends to keep it for capital appreciation.

3.2 Partly owner-occupied and partly leased out (IAS 40.10)

It sometimes happens that land and buildings are partly owner-occupied and partly leased out (joint use properties). These two components may need to be recognised separately:
- the owner-occupied component as property, plant and equipment; and
- the leased out component as investment property.

We would have an:
- investment portion if a portion of the property is used to earn capital appreciation and/ or rental income (an investment property); and
- an owner-occupied portion if a portion of the property is used in the production or supply of goods or services and/ or for administration purposes (an owner-occupied property).

Whether to recognise each portion separately is determined as follows:
- if each portion can be sold or leased out separately (under a finance lease), then each portion is recognised separately (one as an investment property and the other as an owner-occupied property);
- if each portion cannot be sold or leased out separately, then the entire property is recognised as an investment property if the owner-occupied portion is insignificant in relation to the whole property (otherwise the entire property is recognised as property, plant and equipment).

Judgement is required to determine whether a property qualifies as investment property. An entity must thus develop criteria so that it can exercise its judgement consistently.
Example 2: joint use properties

How should Stunning Ltd account for the following property in its financial statements:

A Stunning Ltd owns two freestanding buildings on two separate sites in Durban, South Africa. The first building is used by Stunning Ltd for administration purposes and the second building is leased out to Runodamill Ltd.

B Stunning Ltd owns a building in Cape Town, South Africa, which it uses for administration purposes. The top floor of the 20-storey building is leased to Unpleasant Ltd.

C Stunning Limited owns a 20-storey building in Port Elizabeth. It leases out 19 floors and uses the top floor for the administration of the building.

Solution to example 2: joint use properties

Comment: This example explains how to treat land and buildings that are partly owner-occupied and partly leased out (IAS 40.10).

A. There are two distinct and separate components: owner-occupied and leased out. Since the two components are on two separate sites, it is assumed that they can be sold separately. The owner-occupied portion must be disclosed as property, plant and equipment as it is used for administrative purposes. The leased out portion must be disclosed as investment property.

B. There are two components: owner-occupied and leased out. Since these two components are within one building, it is assumed that they may not be sold separately. Nineteen of the twenty floors is owner-occupied and is therefore the significant component. Stunning Ltd must therefore report the entire building as owner-occupied (i.e. as property, plant and equipment).

C. There are two components: owner-occupied and leased out. Since these two components are within one building, it is assumed that they may not be sold separately. Nineteen of the twenty floors are leased out and the investment portion is therefore the significant component. Stunning Ltd must therefore report the entire building as investment property.

3.3 Properties held under operating leases (IAS 40.6)

If the entity holds a property under an operating lease (leasing it from someone else), the entity may choose to recognise the property as an investment property if:

- the property meets the definition of an investment property (discussed above); and
- the entity uses the fair value model to account for all its investment property.

This option is allowed for properties held under operating leases on a property-by-property basis, but once it is adopted for one property, all other Investment Property must be valued using the fair value model.

If a property held under a lease is classified as an investment property, the lease is treated as a finance lease (not as an operating lease!) with the property then measured in the financial statements at the lower of the fair value of the property and the present value of the minimum lease payments (see the leasing chapter).

3.4 Investment Property and leases in a group context (IAS 40.15)

If a subsidiary (the lessee) leases property from its parent company (the lessor), or vice versa, then the property must be classified as follows:

- in the lessor’s financial statements: as investment property;
- in the lessee’s financial statements: as an operating lease or as investment property if all criteria are met (see above); and
- in the group financial statements: as property, plant and equipment (since, from a group perspective, it is owner-occupied).
Example 3: group Investment Property

Big Limited leases a building from Small Limited, a subsidiary of Big Limited, under an operating lease. The following applies:
- Small Limited purchased the building for €20 million on 1 January 20X5.
- Small Limited’s accounting policy for Investment Property is the fair value model.
- The fair value as at 31 December 20X5 was €20 million.
- The useful life of the building is expected to be 20 years.
- Big Limited does not revalue property, plant and equipment.
- Big Limited uses the fair value model to value its Investment Property.
- Big Limited uses the building for its administration department.

**Required:**
Explain how the building should be accounted for in the financial statements of:
A. Small Limited’s company financial statements.
B. Big Limited’s company financial statements.
C. Big Limited’s group financial statements.

**Solution to example 3: group Investment Property**

A. In Small Limited’s financial statements as at 31 December 20X5: the building must be recognised as investment property. It meets the definition of investment property as it is earning rentals and is not owner-occupied. It should be measured at fair value as the accounting policy of Small Limited is to use the fair value model.

B. In Big Limited’s financial statements as at 31 December 20X5: although Big Limited uses the fair value model for its Investment Property, it cannot choose to recognise the leased building as an investment property because it is occupied by Big Limited for administrative use and thus does not meet the definition of an investment property. Since the building is not an investment property and is held under an operating lease, it will not be recognised as an asset at all. Big Limited will recognise only the lease rental expense.

C. In Big Limited’s group financial statements as at 31 December 20X5: the building must be shown as property, plant and equipment, because, from a group perspective, it is owner-occupied as per IAS 40. It must thus be measured at depreciated historic cost of €19 million, and depreciated over the 20 year useful life.

3.5 Ancillary services (IAS 40.11 - .13)

An entity may provide ancillary services to the occupants of its property (such as maintenance of the building). In such a case, the property may only be treated as an investment property if these services are insignificant to the arrangement as a whole.

As with partly leased out properties, the entity must develop criteria for classification purposes so that it can exercise its judgement consistently.

Example 4: ancillary services

Clumsy Limited owns two properties:
- An office building which it leases out to another company under an operating lease. Clumsy Limited provides security services to the lessee who occupy this building.
- A hotel: Clumsy Limited occupies and manages the hotel itself.

**Required:**
How should Clumsy Limited account for each of its properties?
Solution to example 4: ancillary services

Comment: this example explains how the provision of ancillary services affect the accounting treatment of a property.

- The office building is recognised as an investment property because the security services are insignificant to the rental arrangement as a whole.
- The hotel is recognised as owner-occupied property (i.e. in terms of IAS 16: Property, plant and equipment) because the services provided to the guests are significant to the property.

4. Measurement (IAS 40.30 - .56)

4.1 Overview

IAS 40 allows the entity a choice of two measurement models, but states that once the choice has been made it must be applied to all of its investment properties. The two methods allowed are the:

- cost model; or
- fair value model.

Although there is a free choice, IAS 40 (paragraph 31) expresses preference for the fair value model as it increases the relevance of the financial statements to the user by giving a better reflection of the true value of the property.

4.2 The cost model (IAS 40.56)

The cost model requires the entity to report the property at depreciated historic cost. This is the same as the cost model used for property, plant and equipment (IAS 16).

4.3 The fair value model (IAS 40.33 - .55)

The entity must report the property at its fair value at the end of the reporting period. Any changes in the carrying amount between one year and the next are recognised as a profit or loss in the statement of comprehensive income for the year.

The fair value of a property is the value that the property could be sold for in an arm’s length transaction between knowledgeable, willing parties, without deducting transaction costs. This value must take into account the:

- actual and potential uses;
- market conditions at the end of the reporting period;
- rental incomes; and
- future market conditions.

The standard recommends, but does not require, that this fair value be determined by an independent and suitably qualified valuer.

The fair value must be determined by finding the current price in an active market for a similar property (similar in terms of location, condition etc). If there is no active market for the property then IAS 40 states that the following may be used instead:

- current prices in active markets for properties with a different nature, location or condition with adjustments made to the value for these differences;
- recent prices from less active markets with adjustments for the changes in economic conditions from that date to the end of the reporting period;
- the present value of future cash flows from the expected rental income.
4.3.1 Inability to determine the fair value (IAS 40.53 - .55)

If there is clear evidence when the entity first acquires an investment property that the fair value will not be reliably determinable on a continuing basis, then the entity must measure the property using the cost model. The residual value must be assumed to be zero.

This inability to reliably determine the fair value occurs when comparable market transactions are infrequent and alternative reliable estimates of fair value are not available.

If, on the other hand, fair values were initially available but are no longer available or reliably measurable, the entity must continue to use the fair value model, where the last known fair value remains its carrying amount until a revised fair value becomes available (if ever).

Example 5: fair value cannot be measured

On 31 March 20X5 Clueless Limited purchased a building which it intended to hold for capital appreciation for C1 million. On the purchase date it was unclear what the fair value of the building was. By 31 March 20X6, due to a boom in the property industry, the fair value of the building was estimated to be C15 million.

Required:
Calculate the carrying amount of the investment property on the 31 March 20X5 and 20X6; assuming the following:
- The company’s accounting policy is to carry investment property at fair value;
- Buildings are depreciated over a useful life of 20 years.

Solution to example 5: fair value cannot be measured

As the fair value of the building could not be established at purchase date, IAS 40 requires that the building be carried at depreciated historic cost throughout its life. Even though the fair value can be determined at the next financial year end, the building must remain at depreciated historic cost and must not be revalued to fair value. The year-end carrying amounts of the investment property are:

<table>
<thead>
<tr>
<th>Date</th>
<th>Carrying Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>31 December 20X5</td>
<td>1 000 000 – (1 000 000 / 20 years x 1 year)</td>
</tr>
<tr>
<td>31 December 20X6</td>
<td>1 000 000 – (1 000 000 / 20 years x 2 year)</td>
</tr>
</tbody>
</table>

5. Subsequent expenditure (IAS 40.73 and IAS 40 B40 – B42)

The rules for the capitalisation of subsequent expenditure for investment property are identical to the rules in IAS 16: Property, plant and equipment. Subsequent expenditure can only be added to the cost of the asset if it meets the two recognition criteria which are:
- it is probable that future economic benefits will flow to the entity; and
- the costs can be measured reliably.

Day to day servicing of the asset, including repairs, may not be added to the asset’s carrying amount. These must be expensed in the statement of comprehensive income in the period in which they were incurred. If a part is replaced due to damage, the part that was damaged must be impaired and derecognised. The cost of the replacement part must be capitalised to the asset if recognized criteria are met.
Example 6: subsequent expenditure

During the current year Flower Ltd spent the following amounts on its shopping complex, an investment property:
- C5 000 on building parking bays for the tenants of a shopping complex. The tenants agreed to pay C500 extra each month for the new parking bays.
- C2 000 on rates on the shopping complex.
- The roof of the shopping complex was damaged in a hail storm and Flower Ltd had to pay C25 000 to replace it. A section of the roof, with a carrying amount of C10 000, was scrapped.

Required:
Explain how Flower Ltd should account for the amounts it spent and show the journal entries.

Solution to example 6: subsequent expenditure

The C5 000 can be added to the cost of the asset, as:
- there is an additional C500 revenue (future economic benefits will flow to Flower) per month; and
- the cost is reliably measurable: C5 000.

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shopping complex (asset: investment property)</td>
<td></td>
</tr>
<tr>
<td>Bank/ liability</td>
<td>5 000</td>
</tr>
<tr>
<td>Cost of parking bays</td>
<td>5 000</td>
</tr>
</tbody>
</table>

The rates paid do not increase the earning ability of the property and must therefore be expensed through the statement of comprehensive income.

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rates (expense)</td>
<td></td>
</tr>
<tr>
<td>Bank/ liability</td>
<td>2 000</td>
</tr>
<tr>
<td>Payment of rates</td>
<td></td>
</tr>
</tbody>
</table>

The roof that was destroyed must be impaired to zero as it was scrapped for a nil return. The new roof must be capitalised because:
- the roof will lead to future economic benefits; and
- the C25 000 is measurable.

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Roof written off (expense)</td>
<td></td>
</tr>
<tr>
<td>Shopping complex: roof (asset: investment property)</td>
<td></td>
</tr>
<tr>
<td>Write-off of roof</td>
<td>10 000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shopping complex: roof (asset: investment property)</td>
<td></td>
</tr>
<tr>
<td>Bank/ liability</td>
<td>25 000</td>
</tr>
<tr>
<td>Cost of replacement part capitalized</td>
<td></td>
</tr>
</tbody>
</table>
6. Change in use (IAS 40.57 - .65)

6.1 Overview

The entity may, during the current reporting period, change the use of the property. How a change in use will be reflected in the financial statements depends on whether the entity used the cost or fair value model to measure its investment property.

The following possible changes are envisaged by IAS 40:

<table>
<thead>
<tr>
<th>From</th>
<th>To</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owner-occupied property (IAS 16)</td>
<td>Investment property</td>
</tr>
<tr>
<td>Property under construction (IAS 16)</td>
<td>Investment property</td>
</tr>
<tr>
<td>Inventories (IAS 2)</td>
<td>Investment property</td>
</tr>
<tr>
<td>Investment property</td>
<td>Owner-occupied property (IAS 16)</td>
</tr>
<tr>
<td>Investment property</td>
<td>Inventories (IAS 2)</td>
</tr>
</tbody>
</table>

6.2 If the entity uses the cost model

If the entity uses the cost model, a change in use will not change the carrying amount of the property because (a) investment property, (b) property plant and equipment and (c) inventory are all carried at their cost.

6.3 If the entity uses the fair value model

If the entity uses the fair value model then there may be measurement implications.

6.3.1 Change from owner-occupied property to investment property

The entity must first revalue the property, plant and equipment to its fair value and the resultant increase or decrease is recognised in accordance with the standard on property, plant and equipment (IAS 16):

- An increase is:
  - first credited to income (only where it reverses a previous impairment loss); and
  - then credited to equity (revaluation surplus, as in IAS 16);

- A decrease is:
  - first debited to the revaluation surplus (if the revaluation surplus account has a balance in it from a prior revaluation); and
  - the excess is then debited to expense (impairment loss).

Example 7: change from owner-occupied to investment property

Fantastic Limited had its head office located in De Rust, South Africa. During a ‘freak’ landslide on 30 June 20X5, a building nearby, which it was renting to Unfortunate Limited, was destroyed. As Unfortunate Limited was a valued customer, Fantastic Limited decided to lease 80% of the head office to them as a ‘replacement’:

- The head office was purchased on the 1 January 20X5 for C600 000 (total useful life: 10 years)
- On the 30 June 20X5, the fair value of the head office was C800 000. There was no change in fair value at 31 December 20X5.

Fantastic Ltd uses:

- the fair value model to measure its Investment Property; and
- the cost model to measure its property, plant and equipment.

Required:

Provide the journal entries in the books of Fantastic Ltd for the year ended 31 December 20X5.

*Use a single account to record movements in the head office’s carrying amount.*

*Ignore tax.*
Solution to example 7: change from owner-occupied to investment property

**Comment:** This example explains which accounts are affected by a change in use when an owner-occupied property (IAS 16) becomes an investment property (IAS 40).

<table>
<thead>
<tr>
<th>Date</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 January 20X5</td>
<td>Head-office building:</td>
<td>600 000</td>
</tr>
<tr>
<td></td>
<td>carrying amount (PPE)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Bank/ liability</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Purchase of head-office building(owner-occupied)</strong></td>
<td><strong>600 000</strong></td>
</tr>
<tr>
<td>30 June 20X5</td>
<td>Depreciation</td>
<td>30 000</td>
</tr>
<tr>
<td></td>
<td>Head-office building:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>carrying amount (PPE)</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Depreciation to date of change in use (600 000 / 10 x 6 / 12 months)</strong></td>
<td><strong>30 000</strong></td>
</tr>
<tr>
<td>30 June 20X5 continued …</td>
<td>Investment property</td>
<td>800 000</td>
</tr>
<tr>
<td></td>
<td>Revaluation surplus</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Revaluation of head office to fair value on date of change in use</strong></td>
<td><strong>(800 000 – (600 000 – 30 000))</strong></td>
</tr>
</tbody>
</table>

6.3.2 Change from property under construction or inventories to investment property

Property that is in the process of construction is carried at cost in accordance with IAS 16: Property, plant and equipment. When the property is completed it will be transferred to investment property at cost and then revalued to fair value, with any difference going to the statement of comprehensive income. The same principle applies when classifying a property as investment property that was previously classified as inventory.

**Example 8: completion of self constructed building**

Marvelous Limited constructed a building that it intended to lease out to earn rentals. Construction was completed on the 28 February 20X5 when the fair value was C250 000. The total cost of construction to Marvelous Limited was C45 000, of which C25 000, being the final costs to complete construction (all other costs having been incurred in 20X4), were incurred on the 28 February 20X5.

**Required:**

Provide the journal entries for the year ended 31 December 20X5.

**Solution to example 8: completion of self constructed building**

**Comment:** This example explains which accounts are affected by a change in use when an asset recognised as property, plant and equipment (IAS 16) becomes an investment property (IAS 40).

<table>
<thead>
<tr>
<th>Date</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>28 February 20X5</td>
<td>Property under</td>
<td>25 000</td>
</tr>
<tr>
<td></td>
<td>construction (asset: PPE)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Bank/ liability</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Construction costs incurred in 20X5</strong></td>
<td><strong>25 000</strong></td>
</tr>
<tr>
<td></td>
<td>Investment property</td>
<td>45 000</td>
</tr>
<tr>
<td></td>
<td>Property under</td>
<td></td>
</tr>
<tr>
<td></td>
<td>construction (asset: PPE)</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Self-constructed building transferred to investment property</strong></td>
<td><strong>45 000</strong></td>
</tr>
<tr>
<td></td>
<td>Investment property</td>
<td>(250 000 – 45 000)</td>
</tr>
<tr>
<td></td>
<td>Fair value adjustment of investment property (income)</td>
<td>205 000</td>
</tr>
<tr>
<td></td>
<td><strong>Investment property revalued to fair value on date of completion</strong></td>
<td><strong>205 000</strong></td>
</tr>
</tbody>
</table>
6.3.3 Change from investment property to owner-occupied property or inventories

The entity must first adjust the property’s carrying amount to fair value on the date of change. The resultant change must be taken to the statement of comprehensive income as a gain or loss caused by a fair value adjustment. The fair value on date of transfer, determined in accordance with IAS 40, will then be deemed to be the cost of the owner-occupied property or inventory. If the investment property is classified as owner-occupied, it will then be depreciated over the remaining useful life and measured in terms of IAS 16: Property, plant and equipment. If the investment property is classified as inventory, it will then be measured in terms of IAS 2: Inventories with its cost equaling the fair value on the date of transfer.

Example 9: change from investment property to owner occupied property

Super Limited owned and leased out a building in Pretoria (South Africa), which was correctly classified as an investment property on 31 December 20X4.

During a ‘freak’ earthquake the head office of Super Limited was destroyed, with the result that Super Ltd had to relocate its head office into the Pretoria Building. The tenants of this building were forced to move out as of 30 June 20X5.

The fair value of the building on 31 December 20X4 was C200,000.

On the 30 June 20X5 the buildings
- fair value was C260,000 and
- had a remaining useful life of 10 years.

Required:
Provide the journal entries in Super Limited’s records for the year ended 31 December 20X5.

Solution to example 9: change from investment property to owner occupied property

Comment: this example explains which accounts are affected by a change in use when an investment property (IAS 40) becomes an owner-occupied property (IAS 16).

<table>
<thead>
<tr>
<th>30 June 20X5</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment property (asset)</td>
<td>60,000</td>
<td></td>
</tr>
<tr>
<td>Fair value adjustment of investment property (income)</td>
<td>60,000</td>
<td></td>
</tr>
<tr>
<td>Investment property revalued to fair value on date of transfer (260,000 – 200,000)</td>
<td></td>
<td>60,000</td>
</tr>
<tr>
<td>Office building (asset: PPE)</td>
<td>260,000</td>
<td></td>
</tr>
<tr>
<td>Investment property (asset)</td>
<td></td>
<td>260,000</td>
</tr>
<tr>
<td>Transfer of investment property to property plant an equipment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>13,000</td>
<td></td>
</tr>
<tr>
<td>Office building: accumulated depreciation (asset)</td>
<td></td>
<td>13,000</td>
</tr>
<tr>
<td>Depreciation for the year (260,000 / 10 x 6/12)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
7. Disposal (IAS 40.66–.73)

An investment property must be derecognised (eliminated from the statement of financial position) on disposal or when it is permanently withdrawn from use and no future economic benefits are expected from its disposal.

The difference between the net proceeds on disposal and the carrying amount of the property shall be recognised as a gain or loss in profit or loss (unless IAS 17 requires otherwise in terms of a sale and leaseback) in the period of the retirement or disposal.

Example 10: disposal

Ashley Limited sells an investment property, with a fair value of C75 000, for C100 000. Ashley Limited uses the fair value model.

Required:
Show the journal entries for the disposal.

Solution to example 10: disposal

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank/debtor</td>
<td>100 000</td>
</tr>
<tr>
<td>Investment property (asset)</td>
<td>75 000</td>
</tr>
<tr>
<td>Profit on sale of investment property (income)</td>
<td>100 000 – 75 000</td>
</tr>
<tr>
<td>Sale of investment property</td>
<td>25 000</td>
</tr>
</tbody>
</table>

8. Deferred tax

If the cost model is used, the deferred tax implications are similar to those arising from property, plant and equipment measured in terms of the cost model (IAS 16).

If the fair value model is used, the carrying amount of the investment property changes each time it is fair valued, but the tax base doesn’t change for these adjustments. This results in additional temporary differences.

Deferred tax is measured in terms of how management intends to recover the carrying amount of the asset (i.e. through the use or disposal of the property).

Example 11: deferred tax: intention to keep and use

Cadman Limited owns a building which it leases out under an operating lease.
- The fair value of the building was C3 000 000 on 1 January 20X6 and is C3 600 000 on 31 December 20X6.
- It originally cost C1 500 000 (1 January 20X2).
- The total useful life of the building is 10 years and the tax authorities allow the deduction of an annual building allowance equal to 5% of the cost of the building.

The normal income tax rate is 30%.

The company uses the fair value model to account for Investment Property and has always intended to keep the building.

Required:
Calculate the deferred tax balance as at 31 December 20X6 and show the deferred tax adjusting journal for the year ended 31 December 20X6.
Solution to example 11: deferred tax: intention to keep and use

W1: Deferred tax calculation

<table>
<thead>
<tr>
<th>Investment property</th>
<th>Carrying amount</th>
<th>Tax base</th>
<th>Temporary difference</th>
<th>Deferred taxation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening balance</td>
<td>3 000 000</td>
<td>1 200 000</td>
<td>(1 800 000)</td>
<td>(540 000) Liability</td>
</tr>
<tr>
<td>Movement</td>
<td>600 000</td>
<td>(75 000)</td>
<td>(675 000)</td>
<td>(202 500) Cr DT Dr TE</td>
</tr>
<tr>
<td>Closing balance</td>
<td>3 600 000</td>
<td>1 125 000</td>
<td>(2 475 000)</td>
<td>(742 500) Liability</td>
</tr>
</tbody>
</table>

(1) Fair value
(2) (1 500 000 – 1 500 000 x 5% x 5 years)
(3) (1 500 000 – 1 500 000 x 5% x 4 years)

31 December 20X6

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax expense: normal tax</td>
<td>(742 500 – 540 000)</td>
</tr>
<tr>
<td>Deferred tax: normal tax</td>
<td></td>
</tr>
</tbody>
</table>

Deferred tax on investment property (W1)

9. Disclosure (IAS 40.74 - .79)

9.1 Overview

If the entity uses the cost model then the following additional information must be disclosed:
- the accounting policy for the following:
  - investment property valuation; and
  - depreciation method and rates or useful life.

- the gross carrying amount and accumulated depreciation at the beginning and end of the period
- depreciation and impairments for the current year in the reconciliation and in the statement of comprehensive income.
- the reconciliation of the carrying amount of the investment property at the beginning and end of the period.
- the fair values of the property unless, in exceptional circumstances, these cannot be determined, (in which case the reasons why the fair value was considered to be indeterminable must be disclosed)as well as a description of the investment property and possible range of estimates.

If the entity chooses to use the fair value model, IAS 40 requires the following disclosures:
- an accounting policy note stating that the company is using the fair value model;
- the criteria used to classify property leased by the entity under an operating lease as investment property;
- the criteria that the entity used to determine whether a property was an investment property or owner-occupied (this is only necessary where classification was difficult);
- if and under what circumstances property leased by the entity under an operating lease is classified as investment property;
- a note for investment property that shows the opening balance of the property reconciled to the closing balance including all:
  - additions;
  - additions resulting from business combinations.
transfers to and from inventories and property, plant and equipment;
- fair value adjustments;
- capitalised expenditure; and
- exchange differences.
- assets classified as held for sale

- the following must be included in the note in narrative form:
  - the methods and significant assumptions used in determining the fair value;
  - a statement as to whether or not there is an active market;
  - if there is no active market, a reconciliation from the actual price used and disclosure
    of all the adjustments made;
  - whether an independent and suitably qualified valuator was used; and
  - any securities on the property.

- in a note to the statement of comprehensive income (the profit before tax note is a perfect
  place):
  - rental income earned; and
  - direct operating expenses related to the property, split into those that earned rental
    income and those that did not.
  - Accumulative change in fair value recognized in profit and loss

- if a specific property is carried at depreciated historic cost because the fair value could
  not be determined then the following must be disclosed in relation to that property:
  - a description of the property;
  - a separate reconciliation from opening balance to closing balance;
  - an explanation as to why the fair value could not be determined;
  - a range of estimated fair values within which the fair value of the property could
    possibly lie.
  - on disposal of investment property not carried at fair value.

9.2 Sample disclosure involving Investment Property

<table>
<thead>
<tr>
<th>Company Name</th>
<th>Statement of financial position</th>
<th>As at 31 December 20X5 (extracts)</th>
</tr>
</thead>
<tbody>
<tr>
<td>ASSETS</td>
<td></td>
<td>20X5 C</td>
</tr>
<tr>
<td>Non-current assets</td>
<td>Investment property 27</td>
<td></td>
</tr>
<tr>
<td>EQUITY AND LIABILITIES</td>
<td>Revaluation surplus 25</td>
<td></td>
</tr>
</tbody>
</table>

Company Name
Notes to the financial statements
For the year ended 31 December 20X5 (extracts)

1. Statement of compliance …
2. Accounting policies
2.1 Investment property:

Investment Property are land and buildings held by the group to earn rentals and/or for capital
appreciation. Properties held for resale or that are owner-occupied are not included in Investment
Property. Where investment property is occupied by another company in the group, it is classified
as owner-occupied.

Trendy Limited Group uses the following criteria to identify Investment Property:
- …..
- The following assumptions were made in determining the fair value:
- …

Investment Property are valued at each year-end using the fair value model.
3. **Profit before tax**

   Profit before tax is stated after:

   - **Income:**
     - Income from Investment Property:
     - Fair value adjustments
   - **Expenses:**
     - Investment property expenses:
     - Unoccupied property
     - Properties earning rentals

25 **Revaluation surplus**

   Opening balance
   Revaluation of owner-occupied property that became investment property
   Closing balance

27 **Investment property**

   Opening balance
   - Addition from business combination
   - Capitalised subsequent expenditure
   - Transfer from / (to):
   - from property, plant and equipment after construction complete
   - from property, plant and equipment as no longer owner-occupied
   - to property, plant and equipment as it became owner-occupied
   - to inventory as the property is being re-developed for resale
   - to (or from) non-current assets held for sale
   Closing balance

There is an active market for the investment property.

Included in the above is a property carried at … that has been offered as security for a loan (see note … Loan obligations)
10. Summary

### Property

#### Owner-occupied
- Land/ buildings/ both
- Held by owner or lessee under a finance lease
- For use in supply of goods/services or for admin purposes

Follow IAS 16

#### Investment property
- Land/ buildings/ both
- Held by owner or lessee under a finance lease
- To earn rentals or for capital appreciation

Follow IAS 40

### Recognition and measurement

#### Recognition
- Same as for PPE (IAS 16)
- Definition and recognition criteria must be met

#### Measurement
- Initial measurement: cost
- Subsequent measurement: choose between 2 models
- Subsequent expenditure: normal capitalisation rules (IAS 16)
- Transfers in/ out (5 possibilities)
- Disposals/ purchases (IAS 16)
- Impairments (IAS 36)

### Initial measurement
- Cost
- Including transaction costs

### Subsequent measurement
- Cost model or fair value model
- You can choose which model; except IAS40.34: properties held under operating lease and classified as inv prop must use fair value model (i.e. no choice)
- All property to be measured using the same model; except: Properties described in p32A(a) can be held under a different model to the other properties: not covered

### Cost model
- Follow: IFRS 5: if available for sale; or IAS 16: for all other assets

### Fair value model
- Changes in fair value to be recognised in profit or loss
- If FV becomes no longer available, then last known FV remains the CA until a new FV is available again